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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949.

No. 740

IN THE MATTER OF
FRANKLIN BUILDING COMPANY,
Debtor.

LENA SIMONSEN,
Petitioner,

vs.

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

ARGUMENT

(The sections herein correspond to those in the brief in support of the petition.)

I.

This Claim Was Properly Limited Under the Rule Which Prohibits a Fiduciary from Profiting from His Trust.

A. Section 212 Did Not Repeal That Rule.

It is argued in behalf of the petitioner that a bankruptcy court, in limiting claims, "must do so within the power granted to it by" Section 212 of the Bankruptcy

Act (Br. 11), and two decisions of this Court are cited in support of that proposition. Neither of those cases had anything to do with Section 212 or with the limitation of the claim of a fiduciary.

It is then said that in adopting Section 212 Congress intended to narrow the statutory provisions as to the limitation of claims filed in reorganization proceedings. The fact is that the intent of Congress was to broaden the powers of the reorganization court;[1] but in any event there is nowhere in the Act anything to suggest that Congress intended to define all the grounds upon which claims can be limited or to abrogate the power and duty of the bankruptcy court, as a court of equity, to apply established doctrines such as the rule which prohibits a fiduciary from profiting from his trust.[2] On the contrary, in Section 57k (which Section 102 renders applicable in Chapter X proceedings) the court is specifically authorized to reconsider allowed claims and to reallow or re-

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[1] See, *e.g.*, House Report No. 1409, 75th Cong., 1st Sess. (1937), p. 37:

> "The subject of corporate reorganizations has long been a source of trouble in courts of equity. Although the decisions, occasionally supplemented by statutory enactment, had progressively expanded the jurisdiction and powers of equity courts in respect to these reorganizations, such jurisdiction and powers were still far too restricted to afford adequate relief. In practice, four principal difficulties had been manifest: * * * (4) the lack of adequate judicial control over the activities of persons concerned in reorganizations."

See also 6 *Collier on Bankruptcy*, 14th ed., Sec. 9.28, pp. 2920-2922, and Sec. 9.31, p. 2929.

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[2] *Magruder v. Drury*, 235 U.S. 106, 119 (1914):

> "The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owing in a fiduciary capacity."

See also 1 *Restatement, Trusts*, Sec. 170, p. 431, Sec. 206, Comment i, p. 563; 3 Bogert, *Trusts and Trustees*, Sec. 485, pp. 109-111.

ject them "in whole or in part according to the equities of the case." It could hardly be suggested that the rule should be more rigid as to the original consideration of claims than as to their reconsideration.

Furthermore, petitioner's argument that the bankruptcy court cannot act on the basis of equitable rules is directly contrary to decisions of this Court:

> "In the exercise of its equitable jurisdiction the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate. And its duty so to do is especially clear when the claim seeking allowance accrues to the benefit of an officer, director, or stockholder."[3]

> "This Court has recognized that equity must apply not only the doctrines of unjust enrichment when fiduciaries have yielded to the temptation of self-interest but also a standard of loyalty which will prevent a conflict of interests from arising."[4]

B. Section 212 Authorizes Limitation of This Claim.

It is also argued that this claim could not have been limited under the express provision of Section 212, largely because of the length of time that elapsed between the bond purchases by Mr. Simonsen and the institution of the present proceedings. That contention, of course, raises what is largely a question of fact. It is submitted that the record clearly establishes that William Simonsen, like the other members of the Bondholders Committee, "contemplated" these reorganization proceedings at the times he purchased all of the bonds which are now in dispute.

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[3] *Pepper v. Litton,* 308 U.S. 295, 307 (1939).

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[4] *Manufacturers Trust Company v. Becker,* 338 U.S. 304 (1949).

In this connection it must be borne in mind that there is a distinction between "contemplating" reorganization and believing that the time has arrived to institute reorganization proceedings. It may be conceded that the Bondholders Committee did not consider that the time for reorganization was "ripe" until shortly before the institution of the present proceedings (and the dismissal of the pending proceedings) on May 5, 1947. But reorganization was actually contemplated eleven years before that time.

In his testimony Mr. William A. Schroeder made this distinction very clear (R. 114):

> "Q. Would you be able to say about when you first thought about a reorganization proceeding?
> "A. Oh, well, we thought of it even when time wasn't ripe, John. We thought maybe when we owed 30,000 back taxes yet. We always had in mind because we are worried about somebody coming in and doing—and pushing us to the wall."

The undisputed evidence shows that from 1936 on the members of the Bondholders Committee, including William Simonsen, contemplated reorganizing the company when the time should be "ripe", which meant when "we had enough cash on hand so that we could give a dividend immediately in a reorganization" (R. 112). This appears from the following:

1. Despite the fact that the Bondholders Committee was operating the company's business, all during the years after 1932 the company filed its annual reports with the Wisconsin Secretary of State because "we thought we might later on reorganize and maybe use the company and save that money" (R. 111).

2. At a meeting of bondholders on January 13, 1936, there was talk of foreclosure, receivership, and "a plan to raise a fund to pay outstanding taxes" (Ex. 1, pp. 2-3).

3. On February 4, 1937, debtor filed a petition for reorganization under Section 77B (R. 114); five days later, while that proceeding was pending, William Simonsen made his first purchase of these bonds, at 14% of par (Ex. M). Four months later he made another purchase, this time at 11% of par (Ex. N). Six months after that he made a third purchase at the still lower rate of 9% of par (Ex. L); part of these bonds were resold to another committee member at 20% for a profit of $220.00 (R. 30-31, 33).

4. But the Bondholders Committee felt that the time for reorganization "wasn't really ripe in 1936 and '37" (R. 115).

5. On June 2, 1938 the Bondholders Committee agreed that neither second mortgage bondholders nor stockholders had any more equity in the company (Ex. 1, p. 57).

6. Three months later William Simonsen, knowing that first mortgage bondholders then owned all of the remaining equity in debtor, made another purchase, at 9½% of par (Ex. G).

7. The committee "thought of" reorganization when there were still $30,000 in unpaid back taxes (R. 114); according to the committee's trustee's financial reports, Ex. C, this must have been in or before 1939 or 1940.

8. On May 1, 1940, Mr. Simonsen made his fifth purchase, at 10% of par (Ex. H).

9. At a meeting of the Bondholders Committee on May 21, 1941, "A proposed reorganization of the company under Chapter X was discussed generally without any commitment" (Ex. 1, p. 84).

10. The same subject was discussed at another meeting on July 23, 1941 (Ex. 1, p. 85).

11. On November 20, 1942, Mr. Simonsen made his sixth and last purchase, at just under 15% of par (Ex. J).

It is therefore submitted that Section 212 does not delimit the court's power in respect to claims; that even if it did, the facts bring this case within it; and that accordingly there was no error in the decisions of the lower courts.

II.

The Becker Case Provides Additional Support for the Decision in This Case.

The contention is advanced in part II of petitioner's argument that this Court's recent decision in *Manufacturers Trust Company v. Becker,* 338 U.S. 304 (1949), requires reversal of this case. It is submitted that, on the contrary, that case provides additional support for the decision in this case.

In the Becker case this Court held that, in the typical case of a corporation which was at one time solvent, which has become insolvent but remained a going concern, and the financial condition of which is progressively becoming poorer so that it is becoming less and less a going concern and more and more a prospective subject for judicial relief, the directors of the corporation may profit from the purchase of its securities at a discount (1) while it is solvent, (2) after it becomes insolvent but remains a going concern, and (3) until it becomes so little a going concern and so much a prospective subject for judicial relief that a conflict of interests would be created by permitting the purchases; or until liquidation is imminent; or until the evidence shows that the conflict of interests would be likely to delay liquidation; but not after.

In this case the record establishes that Franklin Building Company never became a going concern; and accordingly all of William Simonsen's bond purchases occurred at times when a conflict of interests necessarily arose.

As a matter of fact, while in the *Becker* case the debtor's condition was gradually *deteriorating* toward the point at which it would become a prospective subject of judicial relief, the debtor in this case was always *below* that point, so far below, in fact, that nearly twenty years were required for its condition to *improve* to where it was ready for reorganization. And while in the *Becker* case it was specifically found that the debtor remained a going concern at all times up to the last debenture purchase, here Franklin Building Company *never became a going concern.*

The fact that the debtor was not even a prospective subject of judicial relief until 1947 was recognized by both its own officers and the members of the Bondholders Committee. As William A. Schroeder, its president and later a committee member, put it, the interested parties had thought about reorganization in 1936 or 1937, but had not considered the time "ripe" until 1947 (R. 115, 112-114). The Bondholders Committee discussed reorganization at its meetings of May 21, 1941 and July 23, 1941 (Ex. 1, pp. 84, 85), but took no action until 1947 (Ex. 1, pp. 149, 153).

The further fact that liquidation was imminent, or at least a constant threat, was of course apparent to the committee when it took over management of the building on September 1, 1932. Liquidation remained a distinct possibility for many years after that, as the minutes of the committee meetings of January 13, 1936 (Ex. 1, pp. 1-3) and February 18, 1938 (Ex. 1, pp. 52-53; Ex. 4) clearly show:

January 13, 1936:

"* * * A. C. Schmidt [Chairman of the Bondholders Committee] advised bondholders that in his opinion, foreclosure proceedings would be advisable as in that way it would be possible on court order to borrow money for the purpose of paying the large sum of accumulated taxes for while the building at the present time is self sustaining, the income is not large enough to retire the accumulated taxes with the annual ten percent interest. This matter was discussed from the floor. Bondholders generally being opposed to foreclosure proceedings. Mr. Arthur Richter discussed the matter from various angles intimating that receivership proceedings might be advisable and stating that if bondholders so desired the trustee under the bond issue, Mr. William F. Reinke would commence receivership and foreclosure proceedings. * * *"

February 18, 1938:

"* * * As reports clearly showed the conditions for a transfer had not as yet been met and while the Committee was reporting progress, there is no doubt that several more years would be required before the financial conditions could be worked out in accordance with the requirements of the Agreement. As a result the Committee would continue in charge under the original agreement and on the suggestion of the Chairman, motion was made and seconded that the Bondholders' Committee, on unanimous consent of all bondholders present, continue to operate in accordance with the Agreement covering the second five year period. This was then put to a vote and carried unanimously. * * * "

But the best evidence of the financial condition and history of Franklin Building Company is in the books and records which were introduced into evidence, including the ledger and journals of William A. Rosenberg, the

Trustee of the Bondholders Committee (Ex. D, E, F), his annual audit reports (Ex. C), and the summaries contained in Exhibits P and Q. From all of these the following history may be reconstructed:

At the time of its organization Franklin Building Company issued $51,000 in common stock in payment for the leasehold upon which the building was later built. That building was commenced in 1929, but construction was stopped in 1930. By that time the cost of the building had exceeded the proceeds of the first mortgage bond issue of $244,400, a second mortgage bond issue in the amount of $52,300 had been sold and even so there were no funds available to complete the building. The testimony indicated that between $50,000 and $100,000 was later expended in finishing construction (R. 39, 153). In addition, unpaid accounts due to contractors and other suppliers and creditors amounted to a total of over $50,000 (Ex. C, Audit Report, September 1, 1932-December 31, 1933).

Franklin Building Company never accomplished the purposes of its organization. It never completed the Marquette Building, never paid the cost of its original capital investment in the building and never became a going concern. It did pay real estate taxes for the year 1930 (which, while the record does not disclose the fact, probably did not include any tax upon the building). But 1931 real estate taxes were not paid until many years later, and the result of their non-payment when due was the first default under the First Mortgage Trust Indenture (Ex. 3).

By the Summer of 1932 it had become apparent that the company would not be able to pay interest due on October 1 of that year on the second mortgage bonds and on November 1 on first mortgage bonds. The result of that

was the formation of the Bondholders Committee in August, and the execution of the Trust Agreement and assignment on August 31, 1932, as previously described.

When the Bondholders Committee took over on September 1, 1932, the condition of the company was even more precarious. There was no money in the bank, rents were tied up by garnishment proceedings and so was the bank account, the ground rent was in default, and the electric power and gas were about to be shut off (R. 39, 137). Thereafter conditions improved somewhat, but no real estate taxes whatever were paid until 1934, and it was not until 1936 that the amount paid on past-due real estate taxes was as much as the amount that accrued and became delinquent during the year (Ex. C, P).

During all this time, of course, bad as the cash position was, the over-all picture was still worse. Interest had been accruing on first mortgage bonds at the rate of $15,892.50 per year from May 1, 1932; and on second mortgage bonds at the rate of $3,661 per year from April 1, 1932. Since the building was constructed upon land in which the company had only a 99-year leasehold interest, depreciation and depletion of the building and the leasehold constituted very real elements of operating cost. These amounted to $5,180.72 and $604.75 per year, respectively, and no provision had been made for them since the acquisition of the leasehold on December 29, 1927 and the cessation of the construction of the building about May 1, 1930. Total accruals were thus $25,338.95 per year, and amounted to more than $35,000 by the end of 1932, in addition to unpaid taxes of nearly $21,000.

The financial history of the debtor can best be summarized by the following tabulation of the net loss from operations, after deduction of accrued interest and deprecia-

tion, adjusted to include as expense only taxes for the respective current years (Ex. C, Q):

Years	Net Loss
1932, Sep. 1 to Dec. 31	$11,500.99
1933	30,872.05
1934	27,689.53
1935	24,235.44
1936	22,373.81
1937	23,875.45
1938	21,148.71
1939	16,197.95
1940	15,786.77
1941	16,337.05
1942	18,156.91
1943	18,739.57
1944	21,348.95
1945	19,292.74
1946	12,449.77
1947, Jan. 1 to May 4	5,320.34

On a cash basis, of course, the situation was also extremely dangerous because of the non-payment of real estate taxes and penalties. The amount of unpaid taxes, penalties, (and loan used for refinancing taxes in 1942), as of the ends of the years from 1932 through 1943, when taxes finally reached a current basis, were as follows (Ex. C):

Year	Unpaid Taxes
1932	$20,984.96
1933	29,235.81
1934	37,269.17
1935	40,999.93

1936	42,413.90
1937	38,984.05
1938	42,545.47
1939	37,033.52
1940	28,509.59
1941	21,456.26
1942	16,834.30
1943	10,483.88

Two conclusions from these facts are inescapable. The first is that Franklin Building Company never became a going concern, and at all times was in a financial condition substantially poorer than that contemplated by the *Becker* case as the dividing line between propriety and impropriety in security purchases.

The second conclusion is that liquidation was imminent, or at least a clear and present danger, at all times until the present reorganization proceedings were commenced in May, 1947. The First Mortgage Trust Indenture was in default for over sixteen years, and foreclosure was possible during all of that time. As a matter of fact, one bondholder did bring action on his bonds, and obtained payment in full of $5,000 worth in 1934 (Ex. P,Q). The only way of averting such actions, and liquidation, would have been by instituting reorganization proceedings; but the company was not in a position to do that until 1947.

So whether this question be approached in terms of the rule of the *Becker* case or of the additional limitation on that rule with respect to the imminence of liquidation, the result is the same. When William Simonsen bought his bonds in the years 1937-1942, for four years before 1937, and for four years after 1942, the company was not (and never had been) a going concern, but was in imminent

danger of liquidation. Therefore, when his bond purchases were made there necessarily arose a substantial conflict of interests, and under the rule of the *Becker* case the standard of loyalty which is applied to fiduciaries requires that he, and his successor, be prevented from profiting from his breach of trust.

Far from demonstrating that the decision of this case was erroneous, the *Becker* case actually provides another authority supporting its correctness.

III.

The Terms of the Trust Agreement Do Not Justify Profits of Bondholders Committee Members.

In Part III of their brief, counsel for the first time advance the argument that the exculpatory provisions of the Trust Agreement creating the Bondholders Committee (Ex. 3) prevent limitation of this claim and require that the fiduciary be allowed to retain the profit accruing from his purchases of the bonds in question.

It is said that such provisions are valid, and 54 *Am. Jur.* 239 is cited in support of that statement. But that authority (Section 301 of the division entitled "Trusts") does not state that such provisions are effective to permit a trustee to retain a profit which has resulted from his breach of trust. On the contrary, it cites in a footnote 1 *Restatement, Trusts,* Section 222(2), page 631, the material portion of which is:

> "A provision in the trust instrument is not effective to relieve the trustee * * * of liability for any profit which the trustee has derived from a breach of trust."

Comment b on the same section states the reason for the rule:

> "No provision in the terms of the trust is effective to relieve the trustee who derives profit from a breach

of trust from liability to the extent of the profit. Such provisions as these are invalid on the ground that it would be contrary to public policy to give effect to them."

The question in this case is whether William Simonsen (or his successor) shall be allowed to retain profits derived from his breaches of trust. The authority cited for the claim that the provisions of paragraph 16 of the Trust Agreement permit him to do so does not in fact support that claim, and on the contrary such provisions are not valid as applied to this question.

CONCLUSION

It is submitted that the petition for certiorari and supporting brief disclose no reason why the decisions of the lower courts as to this claim were erroneous; that in fact those decisions are in accord with the applicable rules of law established by this Court; and that accordingly the petition should be denied.

Dated at Milwaukee, Wisconsin, May 11, 1950.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 740

LENA SIMONSEN, PETITIONER

v.

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY

No. 761

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY, PETITIONER

v.

ROBERT W. SCHROEDER

No. 762

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY, PETITIONER

v.

MOLLIE SCHROEDER AND JUNE KUPTZ

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

PRELIMINARY STATEMENT

The Securities and Exchange Commission, pursuant to Section 208 of the Bankruptcy Act, 11

U.S.C. 608, became a party to the proceeding for the reorganization of Franklin Building Company, debtor, under Chapter X of the Bankruptcy Act. The Commission participated in the consolidated appeals to the court below. That court affirmed the holding of the District Court for the Eastern District of Wisconsin that (1) the claims of the Schroeder family, involved in Nos. 761-762, should be allowed in full, and (2) the claim of Lena Simonsen, involved in No. 740, should be limited to cost. The Commission submits this memorandum in support of the petition in Nos. 761-762, but expresses no opinion as to whether further review is warranted in No. 740.

OPINIONS BELOW

The opinion of the court of appeals (R. 203) is reported at 178 F. 2d 805. The opinion of the district court (R. 173) is reported at 83 F. Supp. 263.

JURISDICTION

The decrees of the court of appeals were entered December 8, 1949 (R. 211, 212). A petition for rehearing by Lena Simonsen was denied January 16, 1950 (R. 213). Jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTIONS PRESENTED

In Nos. 761-762 the question is whether, in a Chapter X proceeding, where a fiduciary is limited to cost on his personal holdings of bonds of a debtor, his wife, son and daughter should be similarly lim-

ited where his and their purchases were equally related to the proceeding and were in effect a family enterprise largely directed by the fiduciary.

In No. 740 the question is whether, in the light of *Manufacturers Trust Company* v. *Becker,* 338 U.S. 304, the particular circumstances warranted the courts below in limiting to cost a claim based on bonds of the debtor purchased by a fiduciary for his personal account. Respondents in Nos. 761-762 may advance contentions raising a similar question.

STATEMENT

The Franklin Building Company, a Wisconsin corporation, was organized in 1927 (R. 2). It erected a five-story business building in Milwaukee upon which it placed a first mortgage to secure its 6½ percent bonds in the principal amount of $250,000 (reduced to 4½ percent in 1931) and a second mortgage to secure its 7½ percent bonds in the principal amount of $60,000 (R. 2-3). In September 1932, the debtor being unable to meet its next interest payments on the mortgages, a bondholders committee of five was formed on behalf of the first mortgage bonds, and the management, control and operation of the Franklin Building was by agreement with the debtor thereupon vested in a trustee chosen by the committee (R. 23-26). There is no dispute that the debtor has been insolvent at all times thereafter.

On February 4, 1937, an involuntary petition for reorganization was filed under Section 77B of the

Bankruptcy Act (R. 114). This petition was dismissed shortly thereafter for want of good faith (R. 114). An involuntary petition under Chapter X was filed in 1943 and was pending until its withdrawal on May 5, 1947. On that date a voluntary petition initiated the instant proceeding (R. 114), in which a plan of reorganization has been confirmed.

The subject of the Trustee's petition (Nos. 761-762) is the treatment accorded below to bonds of Mollie Schroeder in the face amount of $10,000 acquired for $3,780; bonds of June Kuptz in the face amount of $4,500 acquired for $2,270; and bonds of Robert W. Schroeder in the face amount of $10,400, $8,300 of which were acquired for $3,494 and the balance for an unknown amount (R. 205-206). Respondents Mollie Schroeder, June Kuptz and Robert W. Schroeder are the wife, daughter and son, respectively, of William A. Schroeder.

William A. Schroeder was one of the original stockholders and organizers of the debtor corporation and he has served as director and president of the company for substantially all of its history (R. 81-82). He was in active charge of the debtor's affairs until the bondholders committee was formed and took over operation of the property in September 1932 (R. 82). In 1937, he was named as managing agent for the bondholders committee and continued in that capacity until the institution of the

present proceeding (R. 82-83). In November 1944, he also became a member of the bondholders committee. He served in that capacity until May 1947, the month when the present proceeding was instituted (R. 82-83). From July until December of 1947, he served in the present proceeding as additional trustee for the purpose of operating the building (R. 82).

During the period January 1941 through June 1947 William A. Schroeder effected purchases of numerous bonds of the debtor for himself and his family. His purchases included substantially all the bonds forming the basis of the claims of his wife, Mollie Schroeder, and his daughter, June Kuptz, as well as many of those forming the basis of the claim of his son Robert W. Schroeder. The other bonds of these respondents were purchased by the son Robert, who, during a large part of the period, shared offices with his father where they engaged in law practice and the real estate business. Although the testimony as to these respondents is that these bonds were purchased with their own money, William appears to have had complete discretion in making the purchases for his wife[1] and daugh-

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[1] See, *e.g.*, the testimony of William A. Schroeder at R. 100:

Q. Now, taking the bonds that are included in the claim of your wife, Mollie Schroeder, which was filed on September 2, 1947, which includes a total principal amount of first mortgage bonds of $10,000.00, what part did you have in the acquisition of those bonds?

A. Well, I am pretty sure either I or my son bought all the bonds for her, because my wife let me or my son take care of that end of it.

ter.[2] Robert also relied upon his father's superior "business judgment" (R. 68), and when Robert was away in the service he gave his father complete discretion to effect purchases for him.[3] Most of the bonds of Mollie Schroeder and Robert Schroeder and all but one of the bonds of June Kuptz were purchased while William A. Schroeder was both a member of the bondholders committee and its managing agent and during the pendency of the involuntary Chapter X proceeding (Ex. 7-10, 15-21; R. 97-101). The last purchase by June Kuptz occurred one month after the institution of the instant voluntary proceeding and while her father

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[2] See, *e.g.*, the testimony of William A. Schroeder at R. 99:

Q. Did she give you any specific instructions?
A. Sure, she did.
Q. At the price she wanted to buy the bonds?
A. She left that to me.
Q. Or as to the amount she wanted purchased?
A. That is correct.
Q. She left that to you, too?
A. Yes.
Q. Subject, of course, to the amount of money she had?
A. I used my own sense, John.

[3] See, *e.g.*, the testimony of Robert W. Schroeder at R. 67 and 68:

Q. What instructions were included in it with reference to how many bonds should be bought, from whom they should be bought, the price to be paid, and so on?
A. The best answer would be as to how many—how much money I had in the safe; the entire amount.
Q. Authorized to spend the entire amount in the safe to buy bonds for you?
A. That is correct.

* * * * *

Q. I appreciate that. Now, at what price was he to buy them?
A. Whatever the market price might have been * * *.

served as additional trustee in the proceeding. June Kuptz lived with her parents during most of the period in which her bonds were purchased (R. 100).

By order of the district court, William A. Schroeder's participation was limited to cost in respect of the bonds purchased in his own name (R. 177), and no appeal was taken from that determination. The district court, however, refused to limit participation on bonds acquired by the Schroeder family (R. 181-182), and this holding was affirmed by a divided court (R. 208).

Petitioner Lena Simonsen (No. 740) inherited $8,000 of the debtor's first mortgage bonds from her husband, William A. Simonsen (R. 47). He had served as a member of the bondholders committee from 1935 until his death in November 1944 (R. 29). From February 1937 to November 1942 he purchased $8,000 face amount bonds for $871.71, the first of these purchases occurring during the pendency of the involuntary Section 77B petition (R. 146-147). The district court limited the participation of Lena Simonsen on those bonds to the $871.71 paid for them by her husband, and this holding was unanimously affirmed.

ARGUMENT

The question raised by the trustee's petition in Nos. 761-762, the *Schroeder* case, is of substantial importance in the administration of Chapter X and has not been ruled upon by this Court. Irrespective

of where the line is to be drawn as to when purchases by a fiduciary are sufficiently related to the proceeding to warrant limitation to cost, avoidance of lax fiduciary standards is so vital to the entire administration of the statute as to warrant review of the holding below that in effect a fiduciary prohibited from profiting through purchases for his personal account may circumvent the policy of the statute by purchases for the account of his family. In *Manufacturers Trust Company* v. *Becker*, 338 U. S. 304, 314, certiorari was granted to review a similar question, but the Court found it unnecessary to reach that question.

The majority decision below sustaining full participation on the claims of the Schroeder family is in conflict with principles which have been applied in other circuits[4] and, as we show below (pp. 12-13), tends to encourage lax fiduciary standards inconsistent with equitable principles and with the basic purpose of the Act. A major objective of reforms in reorganization practice embodied in the Chandler Act was to prevent abuses whereby "the financial well-being of investors and the public" was "sacrificed to the insiders' desires for protec-

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[4] The cases cited in note 7, *infra*, indicate that similar questions have been recurrent in the lower courts, where they generally have been decided contrary to the decision below. At the present time questions of this nature are involved in other Chapter X reorganizations to which this Commission is a party: *In re Pittsburgh Terminal Coal Corporation*, No. 20716 (W.D. Pa.); *In re Chicago Railways Co.*, No. 63984 (N.D. Ill. E.D.).

tion and for further profit."[5] In our view, fulfilment of this objective requires that participation in a bankruptcy proceeding on claims of members of the immediate family of a fiduciary who entered into transactions in the debtor's securities with the knowledge and assistance of the fiduciary should be subject to the limitations applicable to the claims of the fiduciary himself.

1. In limiting to cost the claim on the bonds acquired by Simonsen while serving as a member of the bondholders committee, the court below cited Section 212 of the Bankruptcy Act which expressly authorizes the judge to "limit any claim or stock acquired by . . . [a] committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor," and applied the rule that "a trustee can make no profit out of his trust" (R. 206). Similar considerations had been expressed by the district court in limiting to cost the Simonsen claim, as well as the claim of William A. Schroeder who did not appeal from that determination.

It is implicit in the decision of the court below (see *infra,* p. 14) that had William A. Schroeder purchased the bonds held by his wife and children for himself rather than for them, participation thereon would have been limited to cost. The majority of the court below held, however, that the im-

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[5] H. Rep. No. 1409, 75th Cong., 1st Sess., p. 37 (1937).

mediate family of William A. Schroeder stand in a different position, since these claimants were not themselves fiduciaries of the bondholders nor acting for a fiduciary, and since their bonds were purchased in their own names and with their own funds. It apparently found irrelevant the facts emphasized in the dissenting opinion (R. 209) that the bond purchases by the Schroeders were a "family enterprise directed by William [A. Schroeder]", who had complete discretion to make purchases for his family and whose own claim had been limited to cost. We agree with the rulings below that Section 212 and applicable equitable principles warrant limiting to cost claims based upon securities acquired by fiduciaries under the circumstances involved in both petitions, but disagree with the failure to limit the claims based upon William A. Schroeder's purchases for the account of his family.[6]

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[6] How fortuitous it was that particular purchases were made for one of the respondents rather than for William A. Schroeder is made clear by his own testimony:

"Q. How did you decide that those particular bonds would be purchased for your daughter?

"A. Because she had some money and we put it—we bought them for her account" (R. 98-99).

* * * * *

"I don't think I hardly had any money, except my wife had some money, so we took her money and bought it" (R. 103).

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"Q. When a bond was offered for sale by, say, Toennessen to you or your son, how was it decided whether that bond would be purchased for your wife, your daughter, your son, or yourself?

"A. We had no rule. I couldn't tell you why we did certain things.

Although this Court in the *Becker* case specifically left open the question whether the claims of the wife and mother of a director should be treated the same as claims of a director, the opinion recognizes that circumstances similar to those relied on in the dissenting opinion below are relevant in dealing with questions of this kind. In connection with its holding that the claim of one Fribourg, a business associate of two of the directors, should be allowed in full, this Court stated that "neither director had any indirect interest in Fribourg's holdings or served as his agent for purchase," that Fribourg's purchases began before these directors were elected, and that "there is nothing in the record to indicate that Fribourg's purchases after the Beckers became directors were influenced by advice from them" (338 U. S. at page 314). In the present case William A. Schroeder would seem to have at least an "indirect interest" in the bonds acquired by his family. Moreover, during his tenure as managing agent and member of the bondholders committee, he served as agent for his family in making most of the purchases, and not only gave

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"Q. What would it depend upon?

"A. It didn't depend upon really particularly anything. We tried to divide them up among the family. . . .

"Q. Then, in part, the decision would depend on who had some free cash?

"A. I mean, maybe, who had too much cash. I think maybe that is the best answer. If, maybe, she had more cash than we thought was necessary, maybe then she used them or Bob used them. As I got slowly on my feet I started buying, too." (R. 112.)

advice and assistance but generally exercised his own discretion in purchasing bonds for them.

The holding below as to the Schroeder family will tend to encourage conflicts of interests by fiduciaries and to open new avenues of evasion of equitable limitations applicable to fiduciaries. In laying down the general rule that limitations applicable to the fiduciary do not apply to his immediate family except upon proof that the relative was acting as a "mere front" for the fiduciary (R. 208), the decision would make relationship immaterial. The importance of relationship, particularly that of a spouse, to a fiduciary has long been recognized by the courts in determining the applicability of equitable sanctions.[7] Although under the decision below the fiduciary may not directly increase his own estate through purchases of the debtor's securities, he is permitted to further the interests of his wife and children and thus receive an economic benefit which may well be the practical equivalent of an increase in his own estate. Thus the fiduciary is permitted to accomplish by indirection what he is forbidden to do directly.[8]

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[7] See *In re Midland United Company*, 159 F. 2d 340, 347 (C.A. 3); *In re Midland United Co.*, 64 F. Supp. 399, 416-417 (D. Del.); see also *Holman* v. *Ryon*, 56 F. 2d 307, 311 (C.A. D.C.); *In re Inland Gas Corp.*, 73 F. Supp. 785 (E.D. Ky.); *In re Fulton's Will*, 253 App. Div. 494, 2 N.Y.S. 2d 917; *Gunther* v. *Gove*, 275 Mass. 235, 175 N.E. 464 (1931); *cf. In re Los Angeles Lumber Products Co.*, 37 F. Supp. 708 (S.D. Calif.).

[8] The difficulties of proof illustrated by the instant case makes unworkable as well as unsound the test of whether the fiduciary may have used a member of his family as a "mere front." Here there were no bank records to be examined since,

To permit the immediate family of a fiduciary to utilize his special information and advice, and indeed his personal services and discretion in effecting purchase transactions, thwarts the purpose of the limitation-to-cost rule to foster undivided loyalty of fiduciaries. With respect to the security holders who sell, any unfairness which might result from a purchase by the fiduciary himself is, of course, equally present when the fiduciary's inside information is used on behalf of another purchaser. More important from the standpoint of the estate is the danger that the fiduciary's personal interest in promoting such a purchase program will influence, whether consciously or not, the day-to-day decisions required in the performance of his fiduciary obligations. The public policy against creation of such conflicting interests, which is at the root of the rule limiting the fiduciary's own claim to cost, seems to us equally applicable where he has acted in furtherance of a purchase program for the account of close relatives.

2. The decision below, insofar as it limited to cost a claim based on purchases by a fiduciary for his own account, is challenged by the Simonsen petition in the light of *Manufacturers Trust Co.* v. *Becker,* 338 U. S. 304, and the Schroeder respond-

according to the Schroeders, the funds used in purchasing the bonds in question were to a substantial extent cash which had been kept in a safe in the office shared by William A. Schroeder and his son Robert, and there was nothing to disprove or corroborate their testimony as to whose money was used (R. 92, 99).

ents may also rely on that decision as furnishing support for the ruling below on grounds which the court below itself rejected. The *Becker* case held, under Chapter XI of the Bankruptcy Act, that claims of fiduciaries, acquired when the debtor was only "technically insolvent" and was, according to the District Court's finding, a "going concern", were not required to be limited to cost (338 U. S. at pp. 308, 312). There, this Court indicated, entirely apart from Section 212 which does not in terms apply to Chapter XI, that there is a point prior to the actual institution of proceedings where the lower federal courts are agreed that insiders' purchases of claims against the debtor should be limited to cost because the debtor is a "prospective subject of judicial relief" (338 U. S. at pp. 313-314).

Unlike the situation in the *Becker* case, in the instant case reorganization proceedings for the debtor were actually pending or imminent throughout the period the purchases in question were made. Simonsen's first purchase while a member of the bondholders committee was made during the pendency of an abortive Section 77B proceeding and the bulk of the purchases by William A. Schroeder and his family occurred during the pendency of the involuntary Chapter X proceeding which immediately preceded the instant proceeding.[9] More-

[9] Indeed, Mollie Schroeder's last purchase was made about a week before (Ex. 16-21), and June Kuptz' last purchase was made a month subsequent to institution of the present proceeding (see, *supra*, p. 6).

over, in the *Becker* case the directors to whom the claimants were related had been outsiders who succeeded in preventing the sale of the property at a very low price by arranging for advances by the claimants of substantial sums of new money to the debtor. In the instant case Simonsen had been a member of the bondholders committee which, through its trustee, managed and operated the debtor's property for some time prior to the purchases in question and William A. Schroeder had been one of the original organizers of the corporation and at all times closely associated with its management. Neither Simonsen nor the Schroeders put fresh money into the corporation but concentrated their entire new investment in the purchase of outstanding claims against the debtor.

Accordingly, we believe the holding below with respect to the Simonsen claim is correct and on its facts consistent with the *Becker* case, and that any attempt of respondents in Nos. 761-762 to support the decision below as to them upon similar grounds would be clearly lacking in merit.

CONCLUSION

The decision below with respect to the Schroeder family is inconsistent with equitable principles and with the spirit and purpose of the Bankruptcy Act as interpreted and applied by other courts of appeals; it raises issues of substantial and recurrent importance in the field of bankruptcy and corporate reorganizations. The trustee's petition

for certiorari in Nos. 761-762 should be granted. The holding below as to Simonsen, challenged by the petition in No. 740, is correct on its facts and is not in conflict with *Manufacturers Trust Company* v. *Becker,* 338 U. S. 304. We express no opinion as to whether, in view of its relation to the questions presented in Nos. 761-762, the petition in No. 740 should be granted.

Respectfully submitted,

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